

Auditor's report

Thaba Chweu Local Municipality

30 June 2015

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Thaba Chweu Local Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Thaba Chweu Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget with actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment to support an adjustment of R1 271 991 547 (2013-14: R130 839 332) made to the opening balance of property, plant and equipment as disclosed in note 37 to the financial statements. I could not confirm the disclosure by alternative means.
5. Furthermore, assets recorded in the asset register to the value of R58 307 241 (2013-14: R111 675 928) could not be physically verified due to the inadequacy of the municipality's fixed asset register.

6. Consequently, I was unable to determine whether any further adjustments were necessary relating to property, plant and equipment of R2 128 401 604 (2013-14: R2 163 377 478) and the related accumulated depreciation of R678 143 890 (2013-14: R591 475 693) as disclosed in note 4 to the statement of financial position and the depreciation expense of R86 017 540 (2013-14: R89 241 449) as disclosed in the statement of financial performance.

Receivables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence to determine whether consumer receivables had been impaired in accordance with GRAP 104 *Financial instruments*. An allowance for the impairment of consumer debtors amounting to R30 837 441 (2013-14: R70 494 407) was disclosed in note 10 to the financial statements, for which I was unable to verify the method and procedures used in calculating the impairment. The accounting records of the municipality did not permit the application of alternative procedures. Consequently, I was unable to determine whether adjustments were necessary to the receivables from exchange transactions amounting to R76 195 075 (2013-14: R68 764 588) disclosed in note 10 to the financial statements and debt impairment of R21 196 068 disclosed in note 24 to the financial statements.

Accumulated surplus

8. I was unable to obtain sufficient appropriate audit evidence for the adjustment of R2 378 808 005 made to the accumulated surplus. I was unable to determine the contra entry to this adjustment due to weakness in the controls of the municipality. In addition the municipality presented revaluation reserves with debit balance of R2 329 856 667 in their statement of financial position which differs from the amount presented in the statement of changes in net assets of R56 229 066, resulting in unreconciled differences of R2 386 085 733. Consequently, I was unable to determine whether adjustments were necessary to the accumulated surplus stated at R4 586 125 581 (2014: 4 644 832 899) and revaluation reserves of R56 229 066 in the statement of changes in net assets and consequential impact on the other account balances and classes of transactions.

Cash flow statement

9. I was unable to obtain sufficient appropriate audit evidence for the differences in the net cash flow from operating activities and net increase in cash and cash equivalents amounts included in the cash flow from operating activities of R54 207 878 (2013-14: R56 341 447) in the cash flow statement. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments to the cash flow statement were necessary.

Value-added tax (VAT)

10. The VAT reconciliation did not agree to the financial statements. I was unable to verify the unreconciled difference by alternative means due to weaknesses in the municipality's system. I was unable to confirm the impact of this on other account balances and classes of transactions. Consequently, I was unable to determine whether any adjustments were necessary relating to the VAT receivable of R8 990 119 (2013-14: R9 580 079) as disclosed in note 9 to the financial statements.

Irregular expenditure

11. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure, as internal controls had not been established to recognise and investigate irregular expenditure identified in the previous year. I could not confirm whether all irregular expenditure had been recorded and investigated by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to irregular expenditure of R171 178 575 (2013-14: R150 572 270) as disclosed in note 42 to the financial statements.

Distribution losses

12. Section 125(2)(d)(i) of the MFMA requires the municipality to disclose the particulars of any material losses in the notes to the financial statements. The municipality did not disclose distribution losses with regard to electricity and water sales, as the municipality had not implemented adequate control measures to reliably calculate these losses. I was unable to determine the total extent of the understatement of distribution losses, as the municipality's records did not permit re-performance.

Preparation of the financial statements

13. I was unable to obtain sufficient appropriate audit evidence that the accounting officer has fulfilled his responsibility of preparing and fairly presenting the financial statements in accordance with SA Standards of GRAP, as written representations in this respect were not provided. I was also unable to obtain written representations from the accounting officer that I had been provided with all relevant information and access as agreed in terms of the audit engagement and that all transactions had been recorded and were reflected in the financial statements. I could not determine the effect of the lack of such representations on the financial position of the municipality at 30 June 2015 and its financial performance and cash flows for the year then ended.

Disclaimer of opinion

14. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

15. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

16. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

Material impairments

17. As disclosed in note 10 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R30 837 441 (2013-14: R70 494 407), which represented 29% (2013-14: 51%) of the total consumer debtors.

Additional matter

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

19. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

20. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Development priority 1: basic service delivery and infrastructure development, on pages ... to ...
22. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
23. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected development priority are as follows:

Basic service delivery and infrastructure development

Usefulness of reported performance information

26. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 75% of the reported objectives were not consistent with those in the approved integrated development plan. This was due to management not adhering to the requirements of the FMPPI relating to implementing proper systems and processes.
27. Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined.
28. Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 67% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI due to a lack of technical indicator descriptions.

Reliability of reported performance information

29. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of documented system descriptions for the accurate recording of actual achievements; technical indicator descriptions for the accurate measurement, recording and monitoring of performance; monitoring of the completeness of source documentation in support of actual achievements; and frequent review of the validity of reported achievements against source documentation.

Additional matter

30. I draw attention to the following matter:

Achievement of planned targets

31. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs 27 to 30 of this report.

Compliance with legislation

32. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

33. The performance management system and related controls were inadequate, as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is to be conducted, organised and managed, as required by section 38 of the MSA and municipal planning and performance management regulation 7.
34. The key performance indicators set by the municipality did not include indicators on the percentage of households with access to basic levels of water and sanitation, electricity and solid waste removal, as required by section 43(2) of the MSA and municipal planning and performance management regulation 10(a).

Annual financial statements, performance report and annual report

35. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Some material misstatements identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.
36. Consolidated annual financial statements were not prepared, as required by section 122(2) of the MFMA.
37. The oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2013-14 annual report had been tabled, as required by section 129(1) of the MFMA.
38. The annual performance report for the year under review did not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(b) and (c) of the MSA.

Procurement and contract management

39. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to supply chain management (SCM) regulation 17(a) and (c).
40. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were also approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
41. Contracts were awarded to bidders that did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
42. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) or did not qualify for the contract, contrary to section 18(1) of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulations 17 and 25(7A).

Human resource management and compensation

43. Job descriptions were not established for all posts in which appointments had been made in the current year, in contravention of section 66(1)(b) of the MSA.
44. Sufficient appropriate audit evidence could not be obtained that appointments had been made in posts of managers directly accountable to the municipal manager that had been advertised, as required by section 56(3) of the MSA.

45. The competencies of senior managers were not assessed in a timely manner to identify and address gaps in competency levels, as required by municipal regulation on minimum competency levels 13.
46. The municipality did not submit a report on compliance with the prescribed competency levels to the National Treasury and relevant provincial treasury, as required by municipal regulation on minimum competency levels 14(2)(a).
47. Sufficient appropriate audit evidence could not be obtained that the appointment of senior managers directly accountable to the municipal manager had been approved by the municipal council, as required by section 56(1)(a) of the MSA.
48. Senior managers did not sign performance agreements, as required by section 57(2)(a) of the MSA.

Expenditure management

49. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
50. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

51. The municipal systems improvement grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.
52. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA. The unspent portion was also not backed by cash in the bank.
53. The municipality did not evaluate its performance in respect of programmes funded by the municipal infrastructure grant allocation, as required by section 12(5) of DoRA.

Revenue management

54. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

- 55. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
- 56. An adequate management and accounting system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.

Consequence management

- 57. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

- 58. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

- 59. The accounting officer did not adequately review the financial statements and the annual performance report prior to their submission for auditing.
- 60. Management did not have sufficient documented policies and procedures to guide the operations of the municipality, resulting in numerous instances of non-compliance with the MFMA, as detailed under the findings on compliance with legislation section of this report.

Financial and performance management

- 61. The municipality did not have a proper record management system to maintain information that supported the reported performance in the annual performance report.
- 62. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.

Governance

63. The internal audit unit and the audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management on improvements to the internal controls to ensure reliable reporting of both financial and performance information as well as compliance with legislation. However, this did not result in an improvement in the controls due to management not implementing the recommendations, which led to my adverse assessment of the impact of this unit and committee.

Auditor-General

Mbombela

14 December 2015



AUDITOR-GENERAL
SOUTH AFRICA

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